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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 650

JOHN NICHOLAS, TRUSTEE OF THE ESTATE OF BEACHCOMBER MOTEL, INC., BANKRUPT,
PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (R. 21–25) is reported at 346 F. 2d 32. The order of the district court (R. 16) is not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on May 25, 1965 (R. 25–26). The trustee's petition for rehearing was filed on June 23, 1965 (R. 26–29) and was denied on July 9, 1965 (R. 29). The petition for a writ of certiorari was filed on October 6, 1965, and was granted on January 17, 1966 (R. 30; 382 U.S. 971). The jurisdiction of this Court rests on Section

24c of the Bankruptcy Act, as amended, and 28 U.S.C. 1254(1).

QUESTION PRESENTED

A debtor in possession operating its business during an arrangement proceeding under Chapter XI of the Bankruptcy Act incurred liability for withholding, employment and excise taxes. Thereafter, the debtor was adjudicated a bankrupt. The trustee in bankruptcy, while admitting his liability for the taxes, failed to pay them or to file tax returns when they became due. The question presented is whether the trustee is liable for delinquency penalties for failure to file timely returns and for interest on the unpaid taxes to the date of payment.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Bankruptcy Act, the Internal Revenue Code of 1954, the Judicial Code and the relevant Treasury Regulations are set forth in the Appendix, *infra*, pp. 28–37.

STATEMENT

On August 6, 1958, the Beachcomber Motel, Inc., finding itself unable to pay its debts as they matured, filed a petition for an arrangement under Chapter XI of the Bankruptcy Act in the United States District Court for the Southern District of Florida (R. 1–6). It proposed a partial payment of its current liabilities to unsecured creditors over a period of seven months (R. 1). During the pendency of the arrangement proceedings, the corporation remained in possession of its property and operated its business. During that

period, the debtor in possession hired and paid employees and withheld from their wages a total of some $467 for income and social security taxes as required by Sections 3102 and 3402 of the Internal Revenue Code of 1954.[1] The debtor also continued the operation of its cabaret and collected $644 in federal excise taxes from its patrons as required by Section 4231(6) of the Code.[2]

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[1] Section 3102 provides in part:

(a) *Requirement.*—The tax imposed by section 3101 [*i.e.* social security] shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. * * *

(b) *Indemnification of Employer.*—Every employer required so to deduct the tax shall be liable for the payment of such tax, and shall be indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

Section 3402 provides in part:

(a) *Requirement of Withholding.*—Every employer making payment of wages shall deduct and withhold upon such wages * * * a tax equal to 14 percent of the amount by which the wages exceed the number of withholding exemptions claimed * * *.

Section 3403 provides:

The employer shall be liable for the payment of the tax required to be deducted and withheld under this chapter, and shall not be liable to any person for the amount of such payment.

[2] Section 4231 provides in part:

There is hereby imposed:

* * * * *

(6) *Cabarets.*—A tax equivalent to 10 percent of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit * * *.

The debtor was unable to work out a plan of arrangement with its creditors and was adjudicated a bankrupt on September 17, 1958 (R. 8). A trustee in bankruptcy, the petitioner here, was appointed on September 19, 1958.

On October 31, 1958, the taxes collected or withheld during the quarter ending September 30, 1958, as well as the employer's contribution to the social security tax imposed by Section 3111,[3] were due to be paid. The trustee did not pay them, nor did he file the returns with respect to those taxes which were required on the same date.[4] On January 31, 1959, the 1958

The tax imposed under this paragraph shall be returned and paid by the person receiving such payments. * * *

[3] Section 3111 provides in part:

(a) *Rate of Tax.*—In addition to other taxes, there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 3121(a)) paid by him with respect to employment (as defined in section 3121(b))—

[4] Section 6011(a) provides:

(a) *General Rule.*—When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

See Treasury Regulations on Employment Tax (1954 Code), Sec. 31.6011(a)-1 and Sec. 31.6011(a)-4; Treasury Regulations 43 (1941 ed.), Sec. 101.33, and Treasury Regulations on Returns and Payment of Certain Excise Taxes, Sec. 477.2 (26 C.F.R. (1949 ed.) § 477.2).

payroll tax imposed on employers by the Federal Unemployment Tax Act fell due.[5] Again the trustee neither paid the tax nor filed the required return.

On April 11, 1963, the United States filed in the bankruptcy proceeding a proof of claim and an administrative expense statement (R. 9). The proof of claim covered approximately $700 for taxes which had accrued prior to the petition for an arrangement filed on August 6, 1958. That claim is not here in dispute. The administrative expense statement sought payment of (a) the taxes that had been withheld or collected or had accrued during the period of operations following the petition for an arrangement,[6] (b) the penalties that had been assessed pursuant to

[5] Sections 3301–3309. Section 3301 (26 U.S.C., 1958 ed.) provides:

> There is hereby imposed on every employer (as defined in section 3306(a)) for the calendar year 1955 and for each calendar year thereafter an excise tax, with respect to having individuals in his employ, equal to 3 percent of the total wages (as defined in section 3306(b)) paid by him during the calendar year with respect to employment (as defined in section 3306(c)) after December 31, 1938.

See Treasury Regulations on Employment Tax (1954 Code), Sec. 31.6011(a)–4.

[6] No allocation between the pre-petition and post-petition periods was made with respect to the federal unemployment tax for 1958, and the entire 1958 tax ($362.29) was in the administrative expense statement (R. 9). While the attribution of the entire tax to the post-petition period may be questioned (see *Pomper* v. *United States*, 196 F. 2d 211 (C.A. 2)), petitioner has never objected to it. For each of the other taxes covered by the administrative expense statement, an allocation was made between the pre-petition and post-petition periods, and only the amounts accruing during the latter period were claimed.

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Section 6651(a) of the Code[7] for failure to file the various returns, and (c) the interest, under Section 6601(a)[8] on the overdue taxes and penalties that had accrued and would accrue until payment.[9]

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[7] Section 6651(a) provides in part:

(a) *Addition to the Tax.*—In case of failure to file any return * * * on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

[8] Section 6601(a) provides:

(a) *General Rule.*—If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

[9] The amounts claimed as administrative expense taxes were itemized as follows (R. 9):

Withholding and Social Security, Qtr. ending 9/58	$519.89*
Assessed Penalty	129.97*
Assessed Interest to 2/2/62	101.54
Accrued Interest to 4/10/63	46.34
Excise, Qtr. ending 9/58	644.00*
Assessed Penalty	161.00*
Assessed Interest to 4/14/59	17.58
Accrued Interest to 4/10/63	192.35
FUTA, 1958	362.29*
Assessed Penalty	54.34*
Assessed Interest to 4/14/59	4.46
Accrued Interest to 4/10/63	99.55
Total Post-petition taxes	$2,333.31

*Plus interest on this amount at 6% per annum or at the rate of $0.31 per day from 4/11/63 to date of payment.

The trustee filed objections (R. 10–11) seeking to reduce the government's administrative expense claims by the amount of the penalties and interest; no objection was made to the claim for the principal amount of the taxes as an expense of administration. Both the referee and the district court allowed the principal of the taxes and the interest which had been assessed thereon (see fn. 9, *supra*) "as an Administrative Tax Claim in the amount of $1,649.76 entitled to a first priority" (R. 13, 16); they both disallowed the claim for penalties and for interest accruing since assessment.

The Court of Appeals for the Fifth Circuit reversed the disallowance of penalties and accrued interest (R. 25–26). The court stated that it was well settled that, although taxes accruing prior to bankruptcy are tax claims that have fourth priority in payment, taxes that accrue as a result of operations after bankruptcy "constitute an expense of administration under §62a of the Act and, as such, are payable as a First priority under § 64a" (R. 23). The court concluded (R. 24–25) that, since under the Bankruptcy Act, "the obligation of the trustee here was the same as if he had been in possession from the filing of the original [Chapter] XI proceedings" for taxes accruing after the petition for arrangement, the trustee was subject under *Boteler* v. *Ingels*, 308 U.S. 57, "to the same obligation to make required returns and payments upon penalty of suffering additions to the tax that a private tax-payer would face."

ARGUMENT

INTRODUCTION AND SUMMARY

The liability of the trustee for the principal amount of the taxes set forth in the government's administrative expense statement (R. 9) is not in issue here. The referee found that the trustee was liable (R. 13), and the trustee has expressly conceded that "taxes incurred by a debtor in possession are entitled to priority under the first priority of Section 64 of the Bankruptcy Act as expenses of administration" (R. 28). The only question, therefore, is whether, where taxes constitute expenses of administration in bankruptcy because they result from the operation of a business by a debtor in possession during an arrangement proceeding, interest imposed by statute for delayed payment, and penalties imposed by statute for failure to file returns, may be collected together with the underlying taxes in the ensuing bankruptcy proceeding. That question is answered affirmatively by Section 960 of the Judicial Code which provides:

> Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business *to the same extent* as if it were conducted by an individual or corporation. [Emphasis added.]

This section makes both trustees in bankruptcy and debtors in possession liable for federal taxes and draws no distinction between operating and liquidat-

ing proceedings.[10] Moreover, interest and penalties on such taxes are included, since they are an integral part of the taxing system of the Internal Revenue Code, which provides that they shall be "assessed, collected, and paid in the same manner as taxes" and shall be deemed included in all references to taxes in the Code (Sections 6601(f)(1) and 6671(a)). The tax which Section 960 directs court officers and agents to pay "to the same extent" as ordinary businesses embraces the entire tax imposed by the revenue act, and, therefore, includes increments and additions to tax which the Court has recognized to be "the traditional and almost universal method of enforcing prompt payment." *Boteler* v. *Ingels,* 308 U.S. 57, 61.

Petitioner urges that such a reading of Section 960 conflicts with the overriding policy of the Bankruptcy Act against post-bankruptcy interest. In fact, however, there is no conflict. The principle that interest ceases to accrue after a petition for arrangement or for adjudication is properly applicable only to claims arising before the petition is filed is inapplicable to the subsequent costs of administering a debtor's estate under judicial supervision for the benefit of creditors. When a business is being conducted, either by a trustee or a debtor in possession, for purposes of liquidation or in the hope of revival, it is of great importance

[10] See *Boteler* v. *Ingels,* 308 U.S. 57 ("operations for purposes of liquidation"); *United States* v. *Sampsell,* 266 F.2d 631 (C.A 9); *City of New York* v. *Rassner,* 127 F. 2d 703, 706 n. 2 (C.A. 2); *In re Loehr,* 98 F. Supp. 402 (E.D. Wis.).

that others be willing to do business with it. Subject to court approval, a trustee will commonly have authority to hire, retain and pay employees and to buy goods for cash or credit. For like reason, Section 344 of the Bankruptcy Act provides for the borrowing of money, with court approval, "upon such terms and conditions and with such security and priority in payment over existing obligations as in the particular case may be equitable." In such transactions, no policy of the Bankruptcy Act proscribes the payment of interest or precludes payments on such contractual liabilities as they mature. Were it otherwise, it would be difficult or impossible for a trustee or a debtor in possession to condnct any business at all.

Federal (and other) taxes incurred after the commencement of proceedings under the Bankruptcy Act, like the commercial transactions that give rise to them, are expenses of administration. While the various taxing authorities, unlike commercial suppliers of goods, services and credit, can neither select their debtors nor negotiate terms and conditions, Section 960 directs that they shall be paid.

Petitioner's contention that the imposition of interest for delayed payment of taxes forces the "premature payment" of the government's claim (Br. p. 7) and is inequitable to other creditors (Br. p. 12) is without merit. It is inaccurate to suggest, as petitioner does, that all expenses of administration must be aggregated before any are paid lest the fund available be insufficient to meet all first priority claims. In the present case wages were paid before the taxes withheld from those wages became due. Moreover,

the bulk of the taxes here involved were withheld from wages, or collected from customers, by command of the Internal Revenue Code and for the benefit of the government. No unfairness to other creditors can be involved in the prompt surrender of such funds when due or in the imposition of interest when payment is deferred. Indeed, Section 7501 of the Code provides that taxes "collected or withheld shall be held to be a special fund in trust for the United States." Against such a trust fund, other actual or potential first priority claimants hold no claim. When such a fund arises in the hands of an officer of a court it is deemed to have been preserved for the beneficiary in accordance with equitable principles, and when it is not surrendered when due the beneficiary should be entitled to interest as the price for the delay in paying him.

Finally, none of the considerations which the petitioner has asserted has relevance to the contested penalties. The penalties were imposed because of the failure of the trustee to file the required returns. The returns could have been filed and the penalties avoided even if the trustee were unwilling or unable to make timely payment of the taxes. Since the trustee has never contested his eventual liability for the taxes, there can be no doubt of his duty to file the required returns. Clearly, the government may penalize the default in that duty.

I. WHEN A DEBTOR IN POSSESSION INCURS LIABILITY FOR FEDERAL TAXES IN THE OPERATION OF ITS BUSINESS DURING A PROCEEDING UNDER CHAPTER XI OF THE BANKRUPTCY ACT, INTEREST ON SUCH TAXES TO THE DATE OF PAYMENT CONSTITUTES AN ADMINISTRATION EXPENSE OF AN ENSUING BANKRUPTCY PROCEEDING.

A. TAXES ACCRUING AS A RESULT OF OPERATIONS DURING AN UNSUCCESSFUL CHAPTER XI PROCEEDING ARE COSTS OF ADMINISTRATION OF AN ENSUING BANKRUPTCY PROCEEDING

The petitioner has expressly conceded (R. 28) that "taxes incurred by a debtor in possession are entitled to priority under the first priority of Section 64 of the Bankruptcy Act as expenses of administration" and are not to be treated as pre-bankruptcy taxes (R. 28).[11] Implicit in that concession is the general proposition that

> * * * an indebtedness validly incurred by a receiver, trustee or debtor in possession during the administration of the proceeding under Chapter XI is a cost and expense of administration, and it continues to be such if bankruptcy is directed, and it is entitled to priority of payment as such. * * * [9 Collier, *Bankruptcy* (14th ed., 1964) ¶10.10 at 510.]

In other words, as the Second, Sixth and Ninth Circuits have held, "When the debtor was displaced by the bankruptcy trustee, there was no break in the continuity in relationship, for the order of adjudication

[11] In *Kalishman* v. *United States*, pending on petition for certiorari, No. 711, this Term, involving the identical issue as to interest, the trustee in bankruptcy did not deny that the taxes incurred by the debtor in possession were properly treated as administration expenses of the subsequent bankruptcy. See 346 F. 2d 514, 517 (C.A. 8). Pursuant to this Court's invitation (382 U.S. 968), petitioner Kalishman has filed a brief *amicus curiae* in this case.

related back and the original petition for an arrangement became the vital date." *City of New York* v. *Rassner*, 127 F. 2d 703, 706 (C.A. 2); *Hercules Service Parts Corp.* v. *United States*, 202 F. 2d 938, 941 (C.A. 6); *United States* v. *Sampsell*, 193 F. 2d 154, 156 (C.A. 9); *In re Airline Arista Printing Corp.*, 156 F. Supp. 403, 405 (S.D.N.Y.), affirmed *per curiam*, 267 F. 2d 333 (C.A. 2).

Specific provisions of the Bankruptcy Act support this settled view that, when a Chapter XI proceeding is followed by bankruptcy, the obligations validly incurred by the debtor in possession during the Chapter XI proceedings are treated as if they had been incurred by the trustee during bankruptcy. Section 302, 11 U.S.C. 702, provides that "the date of adjudication shall be taken to be the date of the filing of the petition [for arrangement] under section 321 or 322 * * *." Section 378(2) provides that a bankruptcy proceeding which follows a Chapter XI proceeding "shall be conducted, so far as posisble, in the same manner and *with like effect* as if a voluntary petition for adjudication in bankruptcy had been entered on the day when the petition under this chapter [XI] was filed * * *" (emphasis added).[12]

[12] This view is further supported by Section 342, which gives a debtor in possession "all the powers of a trustee appointed under this Act, subject, however, at all times to the control of the court"; and by Section 343, under which "the receiver or trustee, or the debtor in possession, shall have the power, upon authorization by and subject to the control of the court, to operate the business and manage the property of the debtor * * *." Both of these sections make clear the status of the debtor in possession as an officer of the court. See 8 Collier, *Bankruptcy* (14th ed., 1964) ¶ 6.31—¶ 6.32 at 957-967.

The gist of the matter is that expenses properly incurred by a debtor in possession as well as those incurred by a trustee in bankruptcy are given a special position by the Act and are collectively distinguished from those liabilities incurred before the estate was brought within the protection and control of the court.[13] The rule is required to effectuate Chapter XI's basic purpose of enabling distressed debtors to rehabilitate their affairs by adjusting their unsecured liabilities in cooperation with their creditors. Since a substantial proportion of Chapter XI proceedings terminate in bankruptcy,[14]

[13] The only distinction which the Bankruptcy Act makes between the administration expenses incurred in arrangement and bankruptcy proceedings clearly demonstrates that the first priority of payment in a bankruptcy proceeding includes the administration expenses of a prior, unsuccessful arrangement proceeding. Thus, the proviso to Section 64a(1) states:

> Where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding * * *.

[14] See the following table:

Fiscal year ended June 30	Chapter XI proceedings filed	Chapter XI proceedings in which debtor adjudicated bankrupt
1961	947	370
1962	903	412
1963	1,188	485
1964	1,088	604

(Tables of Bankruptcy Statistics, published by the Administration Office of the United States Courts, for the fiscal years ending June 30, 1961, through 1964, Tables F2 and F4b, and for the fiscal year ending June 30, 1964, pp. 4 and 5.)

persons who deal with a debtor in possession during the arrangement proceedings would frequently be unwilling to extend him any credit at all—and thus preclude successful rehabilitation—if they knew that, should the arrangement fail, they would be in no better position than persons who extended credit before the arrangement. The Bankruptcy Act thus gives those who deal with an insolvent whose affairs are under judicial control a significantly superior position to those who dealt with him before that occurred.

Thus, in the present case, the trustee's liability for interest that accrued after bankruptcy on the taxes that had been incurred during the Chapter XI proceeding is the same as if the taxes had been incurred during the bankruptcy proceeding itself.

B. THE STATUTORY PLAN OF THE BANKRUPTCY ACT SHOWS THAT INTEREST ON FEDERAL TAXES INCURRED DURING BANKRUPTCY, LIKE THE TAXES THEMSELVES, CONSTITUTE ADMINISTRATION EXPENSES.

In its Proof of Claim and Administrative Expense Statement (R. 9) the government clearly distinguished between taxes accruing prior to the petition for an arrangement and those accruing thereafter. Pre-petition taxes, like all other provable claims, must be proved under Section 57 of the Act. Such taxes are entitled to only a fourth priority under Section 64a. Post-petition taxes, on the other hand, cannot be proved under Section 57, but come within the "actual and necessary costs and expenses" of administration which are subject to approval under Section 62 and, if approved, have first priority under Section 64a.

Michigan v. *Michigan Trust Co.*, 286 U.S. 334; Wurzel, *Taxation During Bankruptcy Liquidation*, 55 Harv. L. Rev. 1141, 1174 (1942); 3 Collier, *Bankruptcy* (14th ed., 1964) ¶ 62.14 at 1529, ¶ 64.106 at 2094.

A creditor whose claim arose prior to the petition for arrangement or adjudication may not prove post-petition interest on his claim. In *Sexton* v. *Dreyfus*, 219 U.S. 339, this Court, relying on the English common law, held that a secured creditor who sold his security after his debtor had filed a petition in bankruptcy could not apply the proceeds first to interest on the debt accruing after bankruptcy and then prove for the deficiency, but rather was required to apply the proceeds first to the liquidation of the debt and interest accrued to the date of the petition. Mr. Justice Holmes, writing for the Court, pointed out that the security could have been sold on the date of the petition—in which case the entire deficiency would have been provable—and that the delay in selling, prompted by the hope of getting a better price, was principally for the benefit of the secured creditor. *Id.* at 345. In *New York* v. *Saper*, 336 U.S. 328, the general rule of *Sexton* was applied to tax claims. In particular, the Court held that, in light of the 1926 and 1938 amendments to the Bankruptcy Act [15] which eliminated the absolute priority that taxes had previously enjoyed and also imposed the requirement that taxes be proved like other claims under Section 57, taxes had been "assimilated * * * to other debts" and, like them, should bear interest only

[15] Act of May 27, 1926, c. 406, 44 Stat. 662, Section 15; Act of June 22, 1938, c. 575, 52 Stat. 840, Section 1.

to the date of bankruptcy and not to the date of payment (*id.* at 337).

While petitioner recognizes (Br. p. 12; see also brief for *amicus curiae* p. 10) that *Saper* dealt only with tax claims arising prior to bankruptcy,[16] he urges that it should be read as governing post-petition tax claims as well. Nothing in the Court's opinion supports that contention. First, *Saper* relied on *Sexton* which was clearly limited to pre-petition claims. Second, *Saper* was concerned with the implications of the subordination of tax claims to costs of administration effected by the 1926 and 1938 amendments; but post-petition taxes payable as costs of administration are not affected by that subordination. Third, *Saper* drew support from the Chandler Act's requirement in Section 57n that tax claims be proved, like all other provable claims, under Section 57; but costs of administration, including post-petition taxes, are not provable under Section 57. Finally, *Saper* did not even refer to the Court's earlier decision in *Boteler* v. *Ingels*, 308 U.S. 57, which held that a trustee in bankruptcy was liable for penalties for failure to pay a State tax which accrued while the business of the bankrupt was being operated for the purpose of liquidation. In sum, *Saper* is clearly limited to pre-petition taxes.

[16] *Saper* has been held applicable to arrangements under Chapter XI, *United States* v. *General Engineering & Mfg. Co.*, 188 F. 2d 80 (C.A. 8), affirmed *per curiam*, 342 U.S. 912. Therefore tax claims accruing prior to a petition for arrangement may bear interest up to but not after the date of the petition.

The decisions following *Saper* cited by petitioner (Br. pp. 12–14) have uniformly concerned pre-petition tax claims. On the other hand, in *In re International Power Securities Corp.*, 109 F. Supp. 544 (D. N.J.), a trustee in a Chapter X reorganization was held liable for the interest accruing on unpaid State franchise taxes where the underlying taxes were payable as administrative expenses. The court held that the claim for interest on such post-petition taxes was governed by the principle of *Boteler* and that the principle of *Saper* was inapplicable.

While *Saper* says nothing concerning interest on taxes accruing as a consequence of the post-petition operation of a business, insofar as *Saper* assimilates tax claims to other claims it implies that there is no bar to interest on post-petition taxes precisely because the Bankruptcy Act does not proscribe such interest on other post-petition claims. Where it is in the interest of pre-petition creditors that the operations of an insolvent business be continued in the hope of effecting rehabilitation or an orderly liquidation, the debtor in possession [17] or the trustee must be able to

[17] The operations carried on by a debtor in possession, like those of a trustee, are clearly intended to be for the benefit of the creditors:

> Thus, it has been held that a debtor in possession holds his powers in a trust for the benefit of the creditors, and that the creditors have the right to require the debtor in possession to exercise those powers for their benefit. It follows that a debtor in possession, in addition to his duty to exercise his power for the benefit of creditors, is under a duty to preserve and protect his title and to maintain his possession for the benefit of creditors. [8 Collier, *Bankruptcy* (14th ed., 1964) ¶ 6.32 at 961.]

transact business on terms which will induce others to deal with an insolvent. Subject to the supervision of the court, the trustee ordinarily may hire employees and pay them in accordance with the employment agreement (*In re Wil-low Cafeterias, Inc.*, 111 F. 2d 429 (C.A. 2)), buy and sell merchandise for cash or credit and pay for purchases in accordance with the terms of sale (*In re Avorn Dress Co.*, 78 F. 2d 681 (C.A. 2), and borrow money and repay it (*In re Delaware Hosiery Mills*, 202 F. 2d 951 (C.A. 3) (*dictum*)). Of course, money is not usually loaned or credit extended without charge—especially to insolvents. In order to facilitate such financial transactions where they serve the interests of the pre-petition creditors, Section 344 provides:

> During the pendency of a proceeding for an arrangement, or after the confirmation of the arrangement where the court has retained jurisdiction, the court may upon cause shown authorize the receiver or trustee, or the debtor in possession, to issue certificates of indebtedness for cash, property, or other consideration approved by the court, upon such terms and conditions and with such security and priority in payment over existing obligations as in the particular case may be equitable.

The purpose and hope of rehabilitation which prompt the commencement of arrangement proceedings and the temporary suspension of the claims of pre-petition creditors may well necessitate the incurring of new

obligations, including the costs of new credit."[18] Thus, the principle which bars post-petition interest on pre-petition claims simply has no bearing on post-petition claims.

In the present case, the debtor in possession incurred liability for taxes as a cost of administration. Those taxes were an inevitable incident to the continued employment of persons to run the business and the operation of a cabaret. The taxes were payable in accordance with the Internal Revenue Code, just as the wages from which the taxes were largely withheld were payable in accordance with the employment contract and just as the costs of the beverages consumed by the patrons of the cabaret were payable in accordance with the terms of the bill of sale. Under the terms of the Internal Revenue Code, the taxes were due on October 31, 1958, and January 31, 1959, and drew interest at 6 percent thereafter. By the very act of continuing to operate the business, the debtor in possession necessarily assumed the obligation to pay the taxes that the Code imposed.

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[18] "The necessity of borrowing money by a debtor in possession is so acute at times, that he is faced with the prospect of either borrowing money to use for his operations or closing his business. Often the loan cannot be procured from friendly sources, and the lender to protect his loan, desires a greater assurance of payment than a priority as an expense of administration on a parity with other expenses of administration. He may require a chattel mortgage on all the machinery, fixtures and equipment of the debtor in possession, or a first lien on all the assets.

"* * * [An order under Section 344] generally sets forth the terms and conditions of *interest*, repayment and the assets to be pledged, if any. * * *" [Weintraub and Levin, *Practical Guide to Bankruptcy and Debtor Relief* (1964) 185–186 (emphasis added).]

If the pre-petition creditors believed that continued operations, with the attendant costs, were more likely to deplete than augment the debtor's assets, they were free to seek an adjudication of bankruptcy. The operations having been continued and taxes having been incurred in consequence, the debtor in possession and his successor trustee, as officers of the court, were liable for such taxes "to the same extent" as if the business had been "conducted by an individual or corporation" (28 U.S.C. 960). Since no principle of bankruptcy law precludes interest on post-petition obligations, there is no reason not to accord the Internal Revenue Code its usual effect.

C. SINCE THE SUMS WITHHELD AND COLLECTED AS TAXES BY THE DEBTOR IN POSSESSION CONSTITUTE A TRUST FUND FOR THE GOVERNMENT, THE TRUSTEE CANNOT JUSTIFY HIS FAILURE TO PAY OVER SUCH SUMS TO THE GOVERNMENT BY THE ALLEGED NEED TO HOLD THEM FOR RATABLE PAYMENT AMONG ALL FIRST PRIORITY CLAIMANTS.

Petitioner urges (Br., p. 15) that if post-petition interest is allowed the trustee is "faced with a dilemma" because premature payment of the taxes "may be at the peril of reducing his estate and not having sufficient assets to pay administration expenses superior to the tax claim." Were the government claiming interest on a pre-petition claim, the trustee's contention would have great force. Since, however, the government's tax claim arises from the post-petition operation of the business, it is hard to see why the timely payment of taxes presents any greater dilemma than the timely payment of the wages from which the taxes were in large part withheld.

While petitioner's contention seems irrelevant to post-petition claims in general, it is particularly inappropriate in the present case where the bulk of the taxes had either been withheld from the wages of employees or collected from the patrons of the cabaret.[19] As to the amounts which had been withheld or collected, the debtor in possession was essentially a collecting agent and custodian for the government. Accordingly, the sums involved did not constitute a fund to which other creditors were entitled to look for the satisfaction of their claims. Indeed, it was a fund which was collected solely by virtue of the Internal Revenue Code and was held solely for the government. Since both the debtor in possession and the trustee were officers of the court and subject to the court's surveillance, there would have been no inequity or unusual burden in requiring that such a fund be surrendered to the government when due.[20]

The special status of the fund collected by the debtor in possession is not left to inference or surmise. Section 7501 of the Internal Revenue Code provides:

> (a) *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United

[19] The aggregate principal amount of taxes due is $1,526.18. Of that amount, approximately $1,111.00 had been withheld or collected.

[20] The trustee's interim report of July 5, 1961 (R. 18) shows that he had a balance on hand of $8,842.13 after paying out $3,824.76 for a variety of administrative expenses.

> States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

It has been held repeatedly that Section 7501 is applicable to taxes withheld or collected by a debtor in possession or a trustee and that the fund must be surrendered by the trustee. *Hercules Service Parts Corp.* v. *United States*, 202 F. 2d 938 (C.A. 6); *United States* v. *Sampsell*, 193 F. 2d 154 (C.A. 9); *City of New York* v. *Rassner*, 127 F. 2d 703 (C.A. 2); *In re Airline-Arista Printing Corp.*, 156 F. Supp. 403 (S.D.N.Y.), affirmed *per curiam*, 267 F. 2d 333 (C.A. 2). The government is entitled to the fund of which it is the beneficiary even though the trustee is unable to pay in full all of the other costs of administration. *City of New York* v. *Rassner, supra; In re Airline-Arista Printing Corp., supra.*

Similarly, the status of the fund is not affected by the provision in Section 64a(1) of the Bankruptcy Act granting precedence (within the first priority) to costs and expenses of an ensuing bankruptcy proceeding over the costs and expenses of a superseded arrangement proceeding. *In re Airline-Arista Printing Corp., supra.* Moreover, because the taxes withheld or collected by a debtor in possession have been continuously under the control of an officer of the court and subject to the supervision of the court, the government need not trace the fund in order to claim the trust. *Hercules Service Parts Corp.* v. *United States, supra;*

United States v. *Sampsell, supra.* As the Second Circuit wrote in *Rassner* (127 F. 2d at 706):

> * * * If we hold that the city must now trace the funds, we state in effect that any beneficiary of a trust which is handled by an officer of a bankruptcy court must always protect himself by petitioning in advance for proper administration of the trust. Thus stated, it can be seen that we would be condoning improper action by a trustee so long as he could successfully get away with it.

Petitioner does not suggest that he did not have sufficient funds available to pay the taxes. The trustee's interim report (R. 17–18) indicates that more than enough cash was available. Since the government had an exclusive right to the sums which had been collected for it, no reason appears why it should not have been timely paid or, failing that, why it should not receive interest to compensate for the delay in payment.

II. THE TRUSTEE IS LIABLE FOR THE STATUTORY PENALTIES FOR FAILURE TO FILE RETURNS

The arguments advanced above with respect to the trustee's liability for interest demonstrate as well that his claim to immunity from the penalties assessed is unfounded. Indeed, the present case is ruled by *Boteler* v. *Ingels,* 308 U.S. 57, where the Court held a trustee in bankruptcy liable for a 100-percent penalty for failure to pay a California automobile license tax which accrued while he was operating the bankrupt's business for purposes of liquidation. The Court there ruled that, since the tax liability and the

penalties were incurred by the trustee after bankruptcy, the State "could not file proof of claim for these fees and penalties as a creditor under § 57" (308 U.S. at 60) and therefore Section 57j, which "prohibits allowance of tax penalties accruing prior to bankruptcy" (*id.* at 59), was inapplicable.[21] The Court found (*id.* at 61) that, under the predecessor of 28 U.S.C. 960 (48 Stat. 993 (1934)), Congress had "with vigor and clarity declared that a trustee and other court appointees who operate businesses must do so subject to state taxes 'the same as if such business[es] were conducted by an individual or corporation'". The Court stated (*ibid.*):

> * * * If businesses in California not conducted by a bankruptcy trustee are delinquent in the fees, they must pay the penalty. However, petitioner's contention would exempt a trustee operating a business in bankruptcy from this double tax liability which other delinquents must bear. A State would thus be accorded the theoretical privilege of taxing businesses operated by trustees in bankruptcy on an equal footing with all other businesses, but would be denied the traditional and almost universal method of enforcing prompt payment.

The reasoning in *Boteler* is equally applicable to the present case, and similarly compels the conclusion that the trustee in bankruptcy here is liable for the statutory penalties that the Internal Revenue Code

[21] In *Simonson* v. *Granquist*, 369 U.S. 38, the Court held that Section 57(j) bars allowance of a claim for tax penalties even though a lien therefor has been perfected prior to filing the petition in bankruptcy. Because, as *Boteler* holds, Section 57(j) is inapplicable to penalties incurred after bankruptcy, *Simonson* does not govern the present case.

imposes for failure timely to file returns. The decision in *Boteler* does not turn upon the fact that it was the State which imposed the penalty but upon the broader ground that, with respect to liabilities incurred while operating a business, a court officer stands on no different footing than anyone else conducting such business.

As we have shown above, the fact that the taxes here accrued while the business was being operated by the debtor in possession in no way relieves the succeeding trustee of the liability. Nor does the trustee deny his liability for the tax. Since "any person made liable for any tax [imposed by the Code] * * * shall make a return" (Section 6011(a)), there is no basis for petitioner's contention (R. 22) that he was under no duty to file returns.

Even if there were merit in the trustee's contention that there is some undue burden in requiring the prompt payment of taxes or some inequity in charging interest for delayed payment, no reason is suggested why the returns could not have been filed on time. Yet it is solely for the failure to file timely returns that penalties are imposed under Section 6651 of the Internal Revenue Code. Thus, even on the supposition that there were valid reasons to defer payment of the taxes, the penalty could have been averted by merely filing the returns without payment of the taxes.

Furthermore, such penalties are imposed "unless it is shown that such failure is due to reasonable cause and not due to willful neglect * * *" (Section 6651 (a)). Since the trustee has never suggested that his default was due to reasonable cause it must be assumed

that it was due to willful neglect. No policy of the bankruptcy law is served by immunizing such conduct from statutory penalties.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

THURGOOD MARSHALL,
Solicitor General.

MITCHELL ROGOVIN,
Assistant Attorney General.

ROBERT S. RIFKIND,
Assistant to the Solicitor General.

I. HENRY KUTZ,
KARL SCHMEIDLER,
Attorneys.

APRIL 1966.

APPENDIX

Bankruptcy Act, c. 541, 30 Stat. 544, as amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840:

SEC. 57. *Proof and Allowance of Claims.* * * *

* * * * *

(j) [as amended by Sec. 14(a), Act of July 7, 1952, c. 579, 66 Stat. 424]. Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law.

* * * * *

(11 U.S.C., Sec. 93.)

SEC. 62 [as amended by Sec. 11(a), Act of June 28, 1946, c. 512, 60 Stat. 329]. *Expenses of Administering Estates; Unauthorized Sharing of Fees; Withholding Allowances.*—a. (1) The actual and necessary costs and expenses incurred by officers, other than referees, in the administration of estates shall, except where other provisions are made for their payment, be reported in detail under oath, and examined and approved or disapproved by the court. If approved, they shall be paid or allowed out of the estates in which they were incurred.

* * * * *

(11 U.S.C., Sec. 102.)

SEC. 64 [as amended by Sec. 19(a), Act of July 7, 1952, c. 579, 66 Stat. 426]. *Debts Which Have Priority.*—a. The debts to have

priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; * * * the costs and expenses of administration, * * * *Provided, however,* That where an order is entered in a proceeding under any chapter of this Act directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any;" * * *.

(11 U.S.C., Sec. 104.)

SEC. 321. A debtor may file a petition under this chapter in a pending bankruptcy proceeding either before or after his adjudication.

(11 U.S.C., Sec. 721.)

SEC. 322. If no bankruptcy proceeding is pending, a debtor may file an original petition under this chapter with the court which would have jurisdiction of a petition for his adjudication.

(11 U.S.C., Sec. 722.)

SEC. 342. Where no receiver or trustee is appointed, the debtor shall continue in possession of his property and shall have all the title and exercise all the powers of a trustee appointed under this Act, subject, however, at all times to the control of the court and to such limitations, restrictions, terms, and conditions as the court may from time to time prescribe.

(11 U.S.C., Sec. 742.)

SEC. 343. The receiver or trustee, or the debtor in possession, shall have the power, upon authorization by and subject to the control of the court, to operate the business and manage the property of the debtor during such period, limited or indefinite, as the court may from time to time fix, and during such operation or management shall file reports thereof with the court at such intervals as the court may designate.

(11 U.S.C., Sec. 743.)

SEC. 378. Upon the entry of an order directing that bankruptcy be proceeded with—

(1) in the case of a petition filed under section 321 of this Act, the bankruptcy proceeding shall be deemed reinstated and thereafter shall be conducted, so far as possible, as if such petition under this chapter had not been filed; and

(2) in the case of a petition filed under section 322 of this Act, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 44 of this Act.

(11 U.S.C., Sec. 778.)

28 U.S.C.:

§ 960. *Tax liability.*

Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

Internal Revenue Code of 1954:

SEC. 3102. DEDUCTION OF TAX FROM WAGES.

(a) *Requirement.*—The tax imposed by section 3101 [i.e. social security] shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. * * *

(b) *Indemnification of Employer.*—Every employer required so to deduct the tax shall be liable for the payment of such tax, and shall be indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

* * * * *

SEC. 3111. RATE OF TAX.

In addition to other taxes, there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 3121(a)) paid by him with respect to employment (as defined in section 3121(b))—

* * * * *

SEC. 3301. RATE OF TAX.

There is hereby imposed on every employer (as defined in section 3306(a)) for the calendar year 1955 and for each calendar year thereafter an excise tax, with respect to having individuals in his employ, equal to 3 percent of the total wages (as defined in section 3306(b)) paid by him during the calendar year with respect to employment (as defined in section 3306(c)) after December 31, 1938.

* * * * *

SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) *Requirement of Withholding.*—Every employer making payment of wages shall deduct and withhold upon such wages * * * a tax equal to 14 percent of the amount by which the wages

exceed the number of withholding exemptions claimed * * *.

* * * * * *

SEC. 3403. LIABILITY FOR TAX.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this chapter, and shall not be liable to any person for the amount of such payment.

SEC. 4231. IMPOSITION OF TAX.

* * * * * *

(6) *Cabarets.*—A tax equivalent to 20 percent of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance. The tax imposed under this paragraph shall be returned and paid by the person receiving such payments. No tax shall be applicable under paragraph (1) or (2) on account of an amount paid with respect to which tax is imposed under this paragraph.

SEC. 6011. GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST.

(a) *General Rule.*—When required by regulations prescribed by the Secretary or his delegate any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms and regulations prescribed by the Secretary or his delegate. Every person required to make a return or statement shall include therein the information required by such forms or regulations.

* * * * * *

SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

(a) *General Rule.*—If any amount of tax imposed by this title (whether required to be shown on a return, or to be paid by stamp or by some other method) is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

* * * * * *

SEC. 6651. FAILURE TO FILE TAX RETURN.

(a) *Addition to the tax.*—In case of failure to file any return required under authority of subchapter A of chapter 61 (other than part III thereof), of subchapter A of chapter 51 (relating to distilled spirits, wines, and beer), or of subchapter A of chapter 52 (relating to tobacco, cigars, cigarettes, and cigarette papers and tubes), or of subchapter A of chapter 53 (relating to machine guns and certain other firearms), on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.

* * * * * *

SEC. 6659. APPLICABLE RULES.

(a) *Additions Treated as Tax.*—Except as otherwise provided in this title—

(1) The additions to the tax, additional amounts, and penalties provided by this chapter shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes;

(2) Any reference in this title to "tax" imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter.

* * * * *

SEC. 7501. LIABILITY FOR TAXES WITHHELD OR COLLECTED.

(a) *General Rule.*—Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

(b) *Penalties.*—

For penalties applicable to violations of this section, see sections 6672 and 7202.

Treasury Regulations on Employment Tax (1954 Code):

§ 31.6071(a)–1 *Time for filing returns and other documents.*

(a) *Federal Insurance Contributions Act and income tax withheld from wages.*—(1) *Quarterly or annual returns.* Each return required to be made under § 31.6011(a)–1, in respect of the taxes imposed by the Federal Insurance Contributions Act, or required to be made under § 31.6011(a)–4, in respect of income tax withheld, shall be filed on or before the last day of the first calendar month following the period for which it is made. However, any such return may be filed on or before the tenth day of the second calendar month following such period if such return is accompanied by depositary receipts, Form 450, showing timely deposits in full payment of such taxes

due for such period. For the purpose of the preceding sentence, a deposit which is not required to be made within such return period may be made on or before the last day of the first calendar month following the close of such period, and the timeliness of the deposit for any month will be determined by the earliest date stamped on the validated Form 450 by an authorized commercial bank or by a Federal Reserve bank.

* * * * *

(26 C.F.R., Sec. 31.6071(a)–1.)

§ 31.6151–1. *Time for paying tax.*

(a) *In general.* The tax required to be reported on each tax return required under this subpart is due and payable to the district director at the time prescribed in § 31.6071(a)–1 for filing such return. See the applicable sections of 26 CFR Part 301 (Regulations on Procedure and Administration), for provisions relating to interest on underpayments, additions to tax, and penalties.

(b) *Use of Government depositaries.* For provisions relating to the use of Federal Reserve banks and authorized commercial banks in depositing the taxes, see §§ 31.6302(c)–1 and 31.6302(c)–2.

(26 C.F.R., Sec. 31.6151–1.)

Treasury Regulations on Procedure and Administration (1954 Code):

§ 301.6601–1. *Interest on underpayments.*

* * * * *

(f) *Applicable rules.* (1) Any interest prescribed by section 6601 shall be assessed and collected in the same manner as tax and shall be paid upon notice and demand by the district director or the director of the regional service center. Any reference in the Code (except in subchapter B, chapter 63, relating to deficiency

procedures) to any tax imposed by the Code shall be deemed also to refer to the interest imposed by section 6601 on such tax. Interest on a tax may be assessed and collected at any time within the period of limitation on collection after assessment of the tax to which it relates. For rules relating to the period of limitation on collection after assessment, see section 6502.

* * * * *

(26 C.F.R., Sec. 301.6601–1.)

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